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Macro-economic developments

- On the global front, Non-farm payrolls in the United States rose by 223,000 in May 2018, higher than market expectations of around 188,000. Also, the unemployment rate fell to an 18-year low of 3.8% in May 2018, compared to 4.1% in March 2018.
- The US Fed hiked rates by 25 bps in its June 2018 meeting, and signalled 2 more rate hikes this year. The Fed has already hiked rates twice this year. The Fed added that economy is growing at a solid rate and jobs gains have been strong in recent months. The Fed revised the US 2018 GDP forecast to 2.8% (up 10 bps from March projection), and it reduced the unemployment rate forecast for 2018 to 3.6% (from 3.8% in March projection).
- In the June 2018 European Central Bank (ECB) meeting, the central bank sounded dovish, as it said that it will end its quantitative easing (QE) programme in December 2018 (compared to September 2018 scheduled earlier), and added that subject to incoming data, they will reduce the monthly pace of the net asset purchases to €15 billion in the last 3 months of CY2018, from €30 billion presently.
- India's current account deficit (CAD) widened to $13 billion (1.9% of GDP) in Q4 FY2018 from $2.6 billion (0.4% of GDP) in the corresponding quarter a year back, but remained marginally lower than the preceding quarter (Q3 FY18) at $13.7 billion or 2.1% of GDP. The year on year increase in CAD was primarily due to rising trade deficit, as imports (both oil & non-oil imports) grew at a faster pace than exports. For the full FY18, CAD rose to $49 billion (1.9% of GDP) from $15 billion (0.7% of GDP) in FY17. However, if oil prices remain elevated or rise further, CAD could increase to 2.5-3% of GDP as per market expectations. Meanwhile, on the positive side, balance of payments (BoP) managed to rise to $42 billion in FY18, compared to $21 billion in FY17. This was primarily due to rise in Capital Account balance, on the back of strong FPI flows (especially on the debt side), healthy FDI inflows and pick-up in NRI deposits and foreign loans.
- The Index of Industrial Production (IIP) growth came in at 4.9%YoY in April 2018 from 4.6%YoY in the previous month—led by Manufacturing sector (78% weight in index), where growth was 5.2%YoY in April 2018.
- The Nikkei India Manufacturing Purchasing Managers Index (PMI) rose to its highest level this calendar year at 53.1 in the month of June 2018 from 51.2 in May 2018, helped by sharpest gains in output and new orders since last December.
- CPI headline inflation continued to rise to 4.9%YoY in May 2018 from 4.6%YoY in April 2018, primarily due to rise in core inflation, and also contributed by rise in food and fuel inflation. Core inflation (ex food & fuel) rose to a multi-year high of 6.2%YoY in May 2018 from 5.9%YoY in April 2018.
- Brent crude price rose during the month and closed at USD 79.44/barrel – up 2.4%.
- INR breached the 69/USD mark intra-month, making it an all-time record low on the back of rising CAD, foreign portfolio outflows and elevated crude oil prices. It finally closed the month at 68.47/USD—down around 1.6%.

Equity market developments and Outlook

- The benchmark Nifty index ended the month on a flat note, amidst rising crude oil prices, weakening rupee, global trade war concerns, and correction in some emerging and Asia ex-japan markets. The Nifty Midcap 50 and the Nifty Smallcap 100 indices closed the month with losses of 3.2% and 8.3% respectively. Sectors which underperformed and closed the month with large losses were power, PSU, realty, and capital goods. Meanwhile, pharma sector saw a bounce-back, after long period of underperformance, with the BSE Healthcare index closing with a gain of 7.7% in June. IT sector also outperformed, with the BSE IT index returning 3.5% during the month.
- Foreign portfolio investors (FPIs) outflows were ₹ 2,577 crore in June, compared to ₹ 9,660 crore in the month of May.
- Domestic Institutional Investors (DIIs) registered a net inflow of ₹ 14,146 crore for the month of June. Of this mutual funds contributed ₹ 8,907 crore and insurance funds contributed ₹ 5,239 crore—which is the highest monthly net purchase in equities by insurance funds since the month of January 2016.
- Global markets closed mixed during the month. The MSCI World index closed the month almost flat with a loss of 0.2%, while the MSCI Emerging Market index returned -4.6% and the MSCI AC Asia Ex-Japan index returned -5.2%, on the back of some global risk aversion and outflows from emerging market and Asia ex-Japan equity funds.
- In the US, the S&P 500 index closed with a gain of 0.5%. Major European markets closed with slight losses in June. Within Asia, China was one the biggest losers with the benchmark Shanghai Composite index falling 8% during the month on the back of trade war concerns. Most other Asian markets also closed the month with significant losses – including Thailand, Hong Kong, Singapore, Korea, Indonesia and Malaysia. Within Asian markets, India and Taiwan were relative outperformers during the month, and closed with marginal losses.
- India was relatively less effected in month of June, which saw large outflows from Asia ex-Japan and emerging market equity funds, therefore resulting in underperformance in those markets, and pressure on their currencies. However, an eye needs to be kept on the weakening Indian currency and global monetary policy and bond yields, which will have an impact on foreign flows into India.
- Broad macro-economic data and high-frequency data point to a recovery in economic growth. However, some macro headwinds remain like elevated and rising crude oil prices and its impact on the twin deficits, rising interest rates and inflation.
- YTD in CY 2018 we have seen a large correction in mid and small cap segment with the benchmark Nifty index returning 1.8%, while the Nifty Midcap 50 and Nifty Smallcap 100 indices have fallen 12.4% and 21% respectively over the same period. As a result, the valuation premium of small/mid-cap to large-cap stocks has reduced considerably, although still at a premium to large caps

Fixed Income market developments and Outlook

- Bond yields were volatile during the month. After the RBI bi-monthly policy review on June 6, 2018 in which the central bank hiked rates by 25 bps, the 10 year bond yield breached the psychological mark of 8%, but intra-month the 10 year bond yield came down to 7.77%-supported by softening crude oil prices and an Open Market Operation (OMO) purchase announcement of Rs. 10,000 crores on June 19, 2018.
- However, in the latter half of the month bond yields hardened again on the back of rising crude oil prices, weakening rupee and foreign outflows. The 10 year yield finally closed the month at 7.90%-up 7 bps.
- India's fiscal deficit for FYTD 19 (upto May) reached 55.3% of the budgeted full year target, compared to 68.3% in the year ago.
- With volatility in the rupee, Foreign Portfolio Investors (FPIs) continued to see net outflows to the tune of around Rs. 11,000 crore in the month of June, compared to Rs. 17,751 crore in the previous month.
- In early July, the government announced hike in Minimum Support Price (MSP) for kharif crops as promised in the Union Budget at 1.5X of cost of produce. The weighted average increase in cost of kharif crops is around 15% in FY19, and is likely to have at least 0.30% upside impact on headline inflation, although food inflation presently remains benign.
- While there are upside risks to inflation due to the recent MSP hike with a possible upward revision of RBI's CPI inflation forecast in its August monetary policy review, we feel that RBI's rate action and policy stance will be data dependent, and especially track the course of inflation (especially food & oil price trajectory), global monetary policy, and fiscal deficit.
- With the yield curve being flat, we continue to prefer the shorter end of the yield curve.